Advisory Committee Review
of
CIC Venture Investment Model

PORTFOLIO MANAGEMENT OPTIONS AND CONCEPTUAL RECOMMENDATIONS

June 27, 2003

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1.0 EXECUTIVE SUMMARY

1.1 ADVISORY COMMITTEE

Crown Investments Corporation (CIC) determined that an appropriate approach to assessing the best means of conducting its facilitation of economic development in Saskatchewan through venture capital investment would be to empanel an independent advisory committee. A committee of six persons with a mix of business and governance experience was recruited and charged with the task.

CIC asked the Advisory Committee to review CIC's wholly owned subsidiary, CIC Industrial Interests Inc. (CIC III), and CIC's NewGrade investment, and consider whether alternative forms of organization structure, ownership, governance and management could better achieve the shareholder's financial and public policy objectives.

1.2 MANDATE OF THE ADVISORY COMMITTEE

The Advisory Committee was asked to assess the options using the following criteria:

1. Maintain or enhance the assets, and their financial returns.
2. Achieve the shareholder's financial and public policy objectives.
3. Increase job creation and economic activity in the Province of Saskatchewan.
4. Reduce costs.
5. Lever greater private sector investment in the Province, and reduce the Province's financial exposure.
6. Attain a more arms-length structure for government's investment functions.
7. Allow the government to replace some or all of its investment and/or future investment allocation with private sector capital.

1.3 OPTIONS CONSIDERED

The Advisory Committee discussed the need for ongoing government participation in the venture investment business and concluded that eliminating government participation was impractical at this time. CIC confirmed for the Committee that a complete exit was not practical and therefore not one of the options to be considered. The Advisory Committee's review was limited to options for the existing portfolio and the process by which future investments should be selected and managed.

The four broad options assessed by the Committee are as follows:

Option	Description
Option 1 – Status Quo	No change to the organization structure, ownership, governance or management of the investment portfolio.
Option 2 – Management & Governance Separation	CIC III becomes an autonomous entity with its own board of directors, management and staff.
Option 3 – Outsourcing Investment Portfolio Management	Following implementation of Option 2, an independent external manager manages the investment portfolio.
Option 4 – Partial Equity Sale	The sale of some of CIC III's shares creating a minority shareholder who would be appropriately involved in the governance of CIC III.

1.4 OPTION ASSESSMENT

The assessment of the options by the Advisory Committee is based on a review of available information, including interviews with industry participants; and, the collective knowledge and experience of the members of the Committee.

1.4.1 OPTION 1 – STATUS QUO

The Advisory Committee recognized the positive aspects of the status quo, and that changes could be made to address some of the gaps related to the status quo without changing the ownership or governance. However, the Committee fundamentally believes that combining the investment role with the subsidiary crown oversight role within CIC reduces the effectiveness of the investment management. The Committee is therefore recommending departure from the status quo.

1.4.2 OPTION 2 – MANAGEMENT & GOVERNANCE SEPARATION

The Advisory Committee believes that Option 2, Management and Governance Separation could improve clarity, transparency, accountability, organizational effectiveness and performance related to the investment function. As well, over time, there may be improvements related to public perception of the role of government in venture investment in Saskatchewan and its beneficial impact on the provincial economy. It is the view of the Committee that the prospective benefits justify the expected incremental cost and that the cost could be mitigated by enhanced investment performance derived from greater focus and accountability. Furthermore, adding an autonomous board better positions CIC III to examine further options.

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1.4.3 OPTION 3 – OUTSOURCING INVESTMENT PORTFOLIO MANAGEMENT

The Advisory Committee is of the view that Option 3, Outsourcing Investment Portfolio Management offers further potential benefits such as: an enhanced ability to attract private sector capital; an ability to capitalize on an opportunity to create a significant private equity investment manager based in Saskatchewan; and, further enhancements to transparency. However, the Advisory Committee is of the view that a new autonomous board of directors for CIC III, to be created with the implementation of Option 2, would more properly lead the future decisions regarding CIC III.

1.4.4 OPTION 4 – PARTIAL EQUITY SALE

Option 4, a Partial Equity Sale of CIC III, to a third party or parties, was rejected by the Advisory Committee due to tax implications and minority shareholder implications. It is believed that investor interest could only be achieved through some form of discount to the buyer or preferential participation in the ultimate returns, neither of which are likely to receive public support. The province would be seen to have taken all the risk but received only part of the benefit.

1.5 RECOMMENDATIONS

The following is a summary of recommendations regarding the organization structure, ownership, governance and management of the investment portfolio.

The Advisory Committee suggests that it is vital to the ultimate success of this initiative that:

1. Appointment of a credible independent board of directors for CIC III be a priority; and,
2. The new board of directors be mandated to execute the implementation of the Committee's recommendations in this report.

1.5.1 RECOMMENDATIONS FOR PHASE 1

1. Ownership of CIC III: No change is recommended. CIC III should continue to be wholly owned by CIC.

2. Assets: All assets currently held by CIC III should remain in the portfolio, with the caveat that asset-by-asset disposition should continue when there are opportunities for sale that meet the investment strategy and guidelines.

3. NewGrade: Transfer ownership to CIC III, provided there are no significant legal or financial impediments. The NewGrade investment should continue to be managed as part of the investment portfolio. The benefits associated with the NewGrade investment would continue to accrue to CIC, albeit indirectly, through CIC's one hundred percent ownership of CIC III.

4. Management & Governance: Separate from CIC.
   a) Appoint to the CIC III Board, competent, credible and experienced individuals from the private sector who have an affinity for Saskatchewan.
   b) CIC III approves investment decisions.
   c) CIC III Board to assume full board responsibility for governance and direction of CIC III.
   d) Transfer appropriate staff from CIC to CIC III.
   e) Cabinet continues to approve public policy initiatives.
   f) The shareholder, CIC, approves auditor appointment, board appointments, dividend policy, capital budgets, and creation of subsidiaries.
   g) CIC evaluates performance of CIC III.

5. Legal Structure: Continue as Saskatchewan *Business Corporations Act* entity.

6. Transparency and Accountability: Public reporting of targets and results such as investment returns for the portfolio, individual hurdle rate targets for investments, and economic development objectives.

7. Branding: Change the name of CIC III to something less directly associated with government.

8. Capitalization: Provide CIC III with an appropriate capital structure that will, in the opinion of the new board, provide a sound financial footing and stability. This may also be accomplished through either an upfront capital injection or an ongoing commitment of funds availability.

1.5.2 CONSIDERATIONS FOR PHASE 2

1. The Advisory Committee is of the view that the new CIC III board should have the full authority and flexibility to make future decisions regarding the optimum management options for CIC III, therefore no specific direct recommendation has been made regarding outsourcing.

2. The Committee believes outsourcing management should be actively considered by the CIC III board as the Committee is of the view that it could offer significant benefits, including facilitating greater access to private sector investment capital for Saskatchewan based initiatives.

3. In addition, the Committee has a view that the outsourcing of management could provide the base and critical mass that could lead to another Greystone-like entity, based in Saskatchewan, operating on a national scale and attracting venture capital investors from across the country who make investments nationally.

2.0 INTRODUCTION

Crown Investments Corporation (CIC) determined that an appropriate approach to assessing the best means of conducting its facilitation of economic development in Saskatchewan through venture capital investment would be to empanel an independent advisory committee. A committee of six persons with a mix of business and governance experience was recruited and charged with the task.

CIC asked the Advisory Committee to review CIC's wholly owned subsidiary, CIC Industrial Interests Inc. (CIC III), and CIC's NewGrade investment, and consider whether alternative forms of organization structure, ownership, governance and management would better achieve the shareholder's financial and public policy objectives for the existing investment holdings of CIC III (including NewGrade) and future investments, and whether there was an opportunity to:

1. Maintain or enhance the assets, and their financial returns.
2. Achieve the shareholder's financial and public policy objectives.
3. Increase job creation and economic activity in the Province of Saskatchewan.
4. Reduce costs.
5. Lever greater private sector investment in the Province, and reduce the Province's financial exposure.
6. Attain a more arms-length structure for government's investment functions.
7. Allow the government to replace some or all of its investment and/or future investment allocation with private sector capital.

Options to be considered included, but were not limited to:

1. Status quo organization and ownership (including joint ventures, project by project disposition);
2. Reorganization of CIC III with no change in ownership (outsourcing management, standalone corporation); and
3. Reorganization of CIC III with changes in ownership (including partial sale of a standalone corporation, partial sale of a sub-set of projects, total sale).

The Advisory Committee discussed the need for ongoing government participation in the venture investment business and concluded that eliminating government participation was impractical at this time. CIC confirmed for the Committee that a complete exit was not practical and therefore not one of the options to be considered. The Advisory Committee's review was limited to options for the existing portfolio and the process by which future investments should be selected and managed.

Terms of Reference of the Advisory Committee are included as Appendix A.

An independent Advisory Committee was recruited by the President and Chief Executive Officer of CIC. The members of the Committee have a wide range of business and governance experience as well as a deep commitment to Saskatchewan. Members of the Advisory Committee are as follows.

Mr. Donald Black, C.M. (committee chair) is the Chief Executive Officer of Greystone Managed Investments, an investment counseling firm based in Regina, operating nationally, and majority owned by its employees. Greystone, Canada's 11th largest pension investment management firm, manages in excess of $15 billion in aggregate assets for pension plans, insurance companies, trusts, foundations, unions and private individuals. Mr. Black is a seasoned financial services executive, having previously been the chief executive officer of an investment dealer firm and two insurance companies including Saskatchewan Government Insurance, as well as director of a variety of companies, including serving as chair of the board of directors of Farm Credit Corporation from 1995 to 2000. In addition, he has served on a number of boards of charities and community organizations. He was appointed a Member of the Order of Canada in October 2002.

Mr. Maurice Delage is the former President & Chief Executive Officer of Aventis Crop Science in North America. Aventis was a global agri-business company focused on high technology crop protection, animal health, seeds, and biotechnology with over 3,500 employees, $800 million $U.S. sales, and $130 million $U.S. in research and development. Mr. Delage retired from corporate business in 2001.

Mr. Delage currently farms and provides private consulting in strategic planning and business development.

Mr. Frank Hart is the President & Chief Executive Officer of Crown Investments Corporation. Mr. Hart is a former partner of a national consulting firm and a former Deputy Minister of Saskatchewan Economic Development & Trade. He is the national chair of the RCMP National Heritage Committee, a director of a number of commercial enterprises, and a recipient of the Queen's Golden Jubilee Medal.

Mr. R.W. (Bob) Peterson is President & Chief Operating Officer for Denro Holdings. Denro is a diversified corporation involved in real estate development, investor fund management and property management. Mr. Peterson is a director of Cameco Corporation and General Properties Ltd. He is Vice-Chair of the Regina Regional Economic Development Corporation, Chair of Ranch Erhlo Society and active in various other community organizations.

Mr. Jim Scharfstein, Q.C. is the Senior Managing Partner of the law firm Scharfstein Gibbings Walen & Fisher LLP with a practice focus of corporate and commercial law. He has been Vice Chair of SaskTel. He has taken leadership roles in a number of local and national charitable organizations including the Vice President of the Children's Wish Foundation of Canada, Chair of the Saskatoon Chapter of the Children's Wish Foundation and Vice-President of B'nai Brith Canada. Mr. Scharfstein was awarded a commemorative medal for the 125th anniversary of the Confederation of Canada in recognition of support and contribution to compatriots, community and Canada.

Ms. Carol Teichrob is a retired businessperson, politician, and farmer. She was the Minister of Education, Municipal Affairs, Culture & Housing and Minister responsible for SaskTel. She is a Councillor and a former Reeve for Corman Park. Past and present directorships include the Saskatchewan and Canadian Federations of Agriculture, Farm Credit Corporation, Saskatchewan Research Council, Saskatoon Chamber of Commerce and the Saskatoon Regional Health Authority. She has been an advisor to the College of Agriculture and the University of Saskatchewan.

3.0 THE REVIEW PROCESS

The Advisory Committee completed the following activities:

1. Reviewed:

    a) CIC's approved investment strategy and guidelines;
    b) Current objectives, performance, governance, and ownership of the investment portfolio;
    c) Current organization structure for CIC III and CIC;
    d) Venture capital environment in Saskatchewan;
    e) Venture capital activity in other jurisdictions;
    f) Previous work conducted by CIC staff on the project; and
    g) Nine responses to the Request for Expressions of Interest dated June 12, 2002.

2. Defined criteria for assessing options.

3. Identified and assessed the options.

4. Considered potential internal and external issues related to the options.

5. Conducted a preliminary assessment of responses to the Request for Expressions of Interest dated June 12, 2002 compared to the criteria.

6. Interviewed two respondents to the Request for Expressions of Interest.

7. Received a presentation from Société Générale de Financement du Québec (SGF).

The Advisory Committee engaged a consultant to provide support such as research and report writing.

4.0 BACKGROUND

4.1 VENTURE CAPITAL IN SASKATCHEWAN

Virtually all governments have recognized the economic benefits achieved through direct involvement in venture capital investment in their jurisdictions. A 2000 survey of 492 venture capital backed companies in Canada indicates those companies grew their employment, sales, research and development expenditures, and exports at rates far exceeding the economy as a whole.[1] In addition to meeting capital needs of entrepreneurs, venture capitalists perform roles such as:

1. Coaching successful operating managers regarding ways to improve their investment attractiveness;
2. Providing investees with management expertise in areas such as strategic planning, marketing, and financial management;
3. Acting as facilitator to bring in other strategic investors; and
4. Assisting with networking (technology, professional advisors, employees, etc.).

Government is an important source of venture capital across Canada. For example, in 2002, governments provided 13% of the venture capital invested in Canada.[2] Examples of significant government investment agencies include:

Government Investment Agency	Book Value - 2002
Business Development Bank of Canada	$271 million (venture capital investments)
Société Générale de Financement du Québec	$3 billion
Manitoba Development Corporation	$92 million

Traditionally Saskatchewan has lagged other provinces in terms of the availability of venture capital. In both 2001 and 2002, Saskatchewan accounted for less than 2% of the venture capital invested in Canada[3] while Saskatchewan accounts for 3.0% of Canadian GDP[4]. Reasons for this include:

1. There are few established private sector investors located in Saskatchewan. This limits the availability of both funds and the related management expertise and support for potential investees.

[1] Economic Impact of Venture Capital, 2000, Business Development Bank of Canada.
[2] Western Canada's Venture Capital Industry in 2002: An Overview of Selected Public Policy Issues, March 2003, MacDonald & Associates. MacDonald and Associates is a leading venture capital research firm, based in Toronto.
[3] Western Canada's Venture Capital Industry in 2002: An Overview of Selected Public Policy Issues, March 2003. MacDonald & Associates.
[4] Saskatchewan Bureau of Statistics for the year 2001.

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[4] Saskatchewan Bureau of Statistics for the year 2001.

2. Lack of interest in Saskatchewan from outside venture capitalists due to distance from traditional investment centers and their lack of understanding of the investment opportunities.
3. Some major private sector investors have significantly decreased their investment funding.
4. Activity in the federal immigrant investment program has decreased. During the late 1980's and the 1990's funds developed under this program were major sources of private venture capital in Saskatchewan.
5. The government is one of the few large-scale investors resident in the province that is proactively seeking large deals. Government accounted for 23% of the venture capital investment in Saskatchewan in 2002[5].

The Advisory Committee recognizes progress has been made in the venture capital industry in Saskatchewan. As stated by MacDonald & Associates, "*After several years of near flat industry activity in Saskatchewan, the trend lines were all positive in 2002. A total of 24 Saskatchewan-based firms secured $47 million by the end of December, which represents a gain of over three times the $14 million invested in 7 companies the year prior. Of primary importance in this development has been the emergence of a new array of locally headquartered investor groups and funds, some of which recently acquired fresh resources.*"[6]

4.2 CIC INVESTMENT STRATEGY

CIC has a leadership role in the province's strategy for economic development focused venture investment since it is the principal instrument through which the government of Saskatchewan invests in enterprises. After reviewing the investment strategy and guidelines for CIC, the Advisory Committee observed that the CIC investment portfolio is intended to support economic development and to provide a reasonable return on investment.

The investment strategy and guidelines for CIC are as follows:

> *CIC's investment strategy is to facilitate and enhance Saskatchewan's economic growth by strategically investing in specific sectors of the economy where wealth and employment growth potential are significant, and where Saskatchewan has identifiable strengths and consequently is, or can be, globally competitive.*

[5] Western Canada's Venture Capital Industry in 2002: An Overview of Selected Public Policy Issues, March 2003. MacDonald & Associates.
[6] Western Canada's Venture Capital Industry in 2002: An Overview of Selected Public Policy Issues, March 2003. MacDonald & Associates.

Guidelines for investments:

1. *Commercially viable with an acceptable rate of return.*
2. *Must result in job creation and increased economic activity.*
3. *Development of a new enterprise in Saskatchewan, or expansion of an existing enterprise currently located in Saskatchewan.*
4. *Investment portfolio will be growth oriented and new investment may be entered into with a long term view.*
5. *Ownership will be proportionate with the level of equity investment.*
6. *Must be a strategic fit with CIC's existing investment portfolio in terms of industry, sector, size and portfolio mix.*
7. *Must include a significant component of private sector investment.*

Prudent financial reporting has resulted in portfolio book value that understates the estimated market value.

4.3 INVESTMENT PORTFOLIO GOVERNANCE

CIC Industrial Interests Inc. (CIC III) was incorporated in 1979 under *The Business Corporations Act (Saskatchewan)* as a wholly-owned subsidiary of CIC. CIC III was created as a vehicle to hold certain investments of a commercial nature that involve some degree of private ownership.

All direct investments currently held, with the exception of NewGrade, are **owned** by CIC III. NewGrade is owned directly by CIC.

CIC III currently exists only as a holding company. It is not operational, has no staff and its board of directors is "nominal" in that it is comprised of CIC staff and the Minister.

Primary responsibility for management of the investment portfolio is assigned to personnel in CIC's Investments Division. Other required services such as finance, human resources, communications, legal and administrative support are provided by other CIC divisions.

The Investments Division of CIC operates under various delegations of authorities including, but not limited to:

1. For investments included as part of the former SEDCO portfolio, management has the authority to make loans up to $250,000 and to dispose of real property up to $2.5 million.
2. For investments included as part of the former SOCO portfolio, management has the authority to make equity investments up to $250,000; to dispose of assets up to $500,000; and, to make loans and guarantees up to $500,000.

3. For investments included within the funds, the fund manager makes all individual investment decisions. CIC Board approval and an OC are required for the initial investment in the fund.
4. For direct investments made by CIC III, all acquisitions and divestitures are recommended for the approval of the CIC Board and/or Order in Council.

Direct investments made by CIC III are subject to different CIC procedures than investments made by the subsidiary crowns such as SaskTel and SaskPower. CIC's Finance and Crown Corporation Services staff reviews subsidiary crown investments prior to the CIC Board whereas CIC III's investments go directly from the CIC Investments Division to the CIC Board.

The CIC Board provides oversight of CIC, including CIC III and the investment portfolio.

With regards to the investment portfolio, Cabinet currently:

1. Determines public policy initiatives for the crown sector, including CIC and its wholly owned subsidiary, CIC III;
2. Approves individual investment decisions that are beyond the authorities delegated to CIC; and
3. Approves foreign investments and the creation of subsidiaries by either CIC III or CIC.

4.4 THE INVESTMENT PORTFOLIO

The investment portfolio of assets over $3 million at Dec. 31, 2002 ($ millions) included:

Investment	CIC Equity	Ownership Interest	CIC Debt *	CIC Guarantee	Provincial Guarantee	Total
MLPLP 1	(47.2)	50%	216.4	72.0	-	**241.2**
Haro/Crown Life 2	68.0	Non-voting shares	139.0	-	-	**207.0**
NewGrade Energy Inc. 3	12.0	50%	-	51.8	67. 0	**130.8**
SaskFerco Products Inc. 4	116.1	49%	-	-	80.7	**196.8**
OSB Facility 5	23.9	25%	-	27.5	-	**51.4**
Centennial Food Corp.	18.0	35%	-	-	-	**18.0**
Belle Plaine Ethanol Plant 6	5.6		12.7	-	-	**18.3**
Big Sky Farms Inc.	14.9	41.2%	-	-	-	**14.9**
Premium Brands Inc.	15.0	12.1%	-	-	-	**15.0**
Mitchell's Gourmet Foods	-		10.1	-	-	**10.1**
Genex Swine Group	10.8	85.4%	-	-	-	**10.8**
Canadian Western Bank	3.1					**3.1**
Investment Funds (5) 7	18.2		-	-	-	**18.2**
TOTAL	**258.4**	**N/A**	**378.2**	**151.3**	**147.7**	**935.6**

* Presented as current outstanding debt *before* provisions.

1. Excluding a $50.0 M infrastructure grant to MLPLP in 1991, and interest loans booked as deferred interest.
2. Excluding capitalized interest on the loan.
3. Represents CIC's position subsequent to the Oct. 21/94 financial restructuring. In addition CIC had invested $239.1 M and had written off $234.4 M in NewGrade that was removed from NewGrade's financial statements at the date of restructuring. The amounts presented also exclude $25.0 M in non-repayable grants to NewGrade from 1994 to 1996 to reduce third party debt.
4. The Guarantee is U.S.$129.00 M, less $123.0 M Can. held in a sinking fund by SaskFerco for repayment of debt guaranteed by the Province.
5. CIC has $27.5 M equity commitment to the project. $23.9 M was disbursed at Dec. 31/02.
6. Amounts are committed subject to due diligence but not disbursed.
7. Represents amounts disbursed to 5 investment funds @ Dec. 31/02. Total commitment to the five funds is $93.1 M, as follows Foragen Technologies Fund $14.0 M, Primaxis Technology Ventures Fund $5.0 M, Western Life Sciences Venture Fund $10.0 M, Prairie Ventures Fund $25.0 M over 5 years, and Crown Fund One $39.1 M.

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Belle Plaine Ethanol Plant 6	5.6		12.7	-	-	**18.3**
Big Sky Farms Inc.	14.9	41.2%	-	-	-	**14.9**
Premium Brands Inc.	15.0	12.1%	-	-	-	**15.0**
Mitchell's Gourmet Foods	-		10.1	-	-	**10.1**
Genex Swine Group	10.8	85.4%	-	-	-	**10.8**
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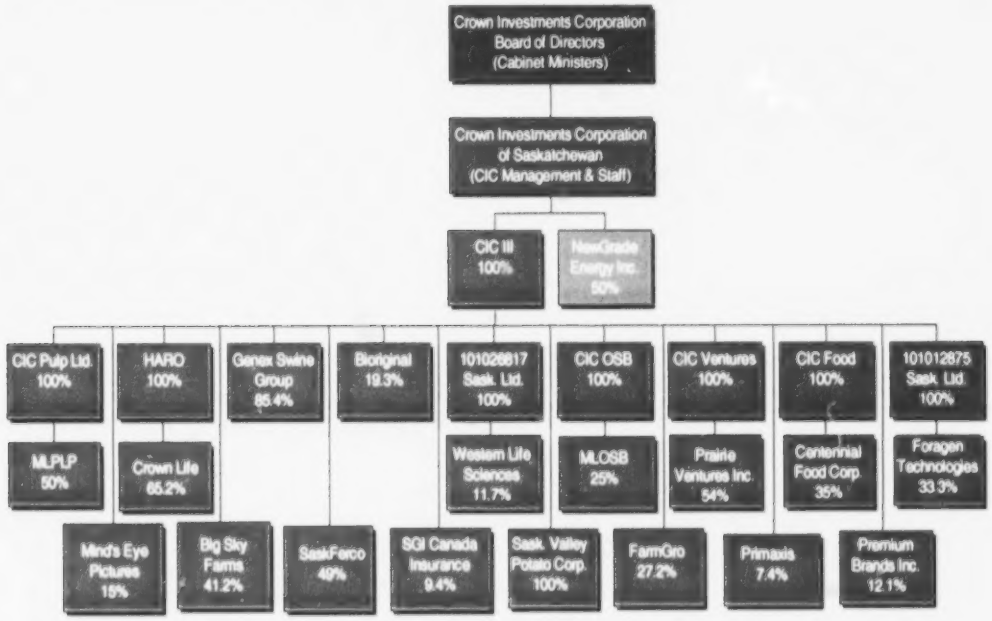
CIC's Major Investments @ December 31, 2002



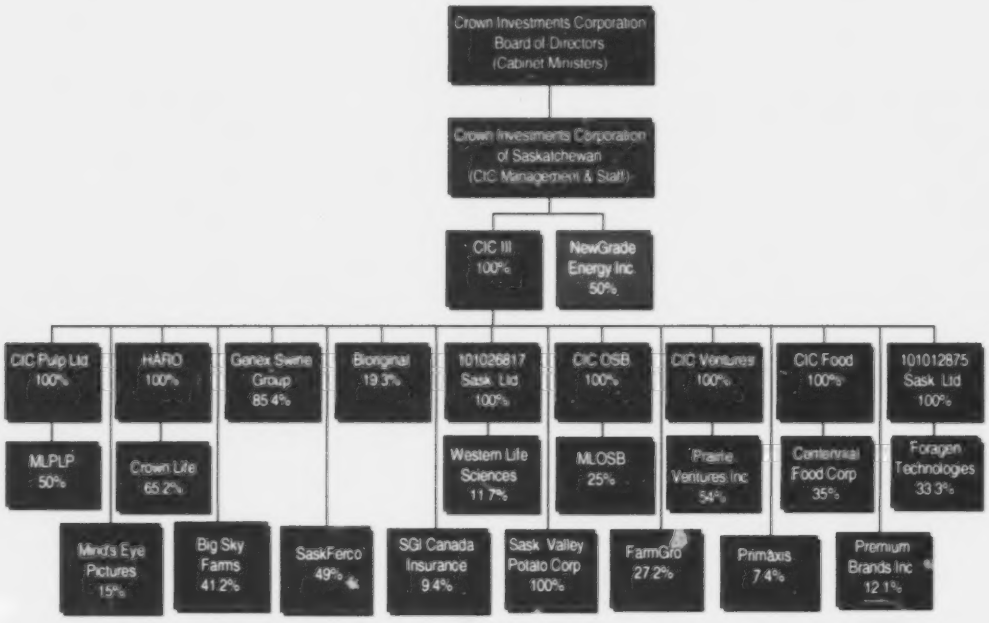
4.5 INVESTMENT PORTFOLIO PERFORMANCE

The portfolio has had positive economic impacts such as[7]:

- From 1999 to 2002, the investee companies created over 850 direct jobs.
- From 1999 to 2002, CIC III leveraged its investment portfolio with private sector funds at a rate of 2.4 to 1 (i.e. for every dollar committed by CIC III, the private sector committed $2.40).
- For the year ending December 31, 2002, investee companies had Saskatchewan purchases of over $900 million.
- For the year ending December 31, 2002, investee companies had annual revenues of $2.8 billion.
- Several large-scale enterprises such as Saskferco, NewGrade, the Bi-Provincial Upgrader and the Meadow Lake Pulp Mill continue to operate in the province. Without the initial government investment, it is unlikely these projects would have proceeded and been sustained.

[7] CIC Investment Mandate, Portfolio and Results updated to December 31, 2002.

CIC's Major Investments @ December 31, 2002



4.5 INVESTMENT PORTFOLIO PERFORMANCE

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[7] CIC Investment Mandate, Portfolio and Results updated to December 31, 2002.

A key performance measure for the investment portfolio has been appropriate private sector involvement. Until 2000, private sector involvement was negotiated on an investment-by-investment basis. With the introduction of investment in funds in 2000, the government joins other investors in a jointly owned pool of funds. The fund manager negotiates the terms of the individual investments.

Investors typically rely on measures such as market value or return on equity to assess financial performance. Because the portfolio is primarily made up of large, relatively illiquid assets, there is no readily available market valuation. Calculating the return on equity (ROE) from the annual audited financial statements is subject to distortion because:

- There is a mismatch between the timing of write-downs and sales related to individual investments;
- It ignores potential gains in value that have not been realized by sale of the asset; and
- No interest or administration expenses are included in CIC III's financial statements.

ROE presented as an average over ten years reduces to some extent, although not entirely, the distortions due to mismatches.

The average return on equity for the CIC III investment portfolio (including Cameco and NewGrade) has been 8.4% for the past five years (1998-2002) and 6.7% for the past ten years (1993-2002). This return on the government's investment in the portfolio has been calculated using a methodology similar to SGF[8], with adjustments to include Cameco earnings, NewGrade earnings, imputed equity for Cameco, imputed interest expense and an allocation for administration costs.

The reported annual return on equity for the year 2002 was 4.8% before any imputed interest or administration costs.[9] Conventional venture investment organizations or funds would report returns net of all costs, including costs of administration and interest, where applicable.

[8] SGF is a Quebec government owned entity with an economic development and investment mandate. SGF believes a five-year perspective is appropriate.
[9] CIC Annual Report 2002, p.5.

5.0 OPTIONS

5.1 OVERVIEW OF OPTIONS

The Advisory Committee assessed four options for the future governance and ownership of the investment portfolio:

1. Status Quo
2. Management & Governance Separation
3. Outsourcing Investment Portfolio Management
4. Partial Equity Sale.

Highlights of the four options are summarized in the following chart.

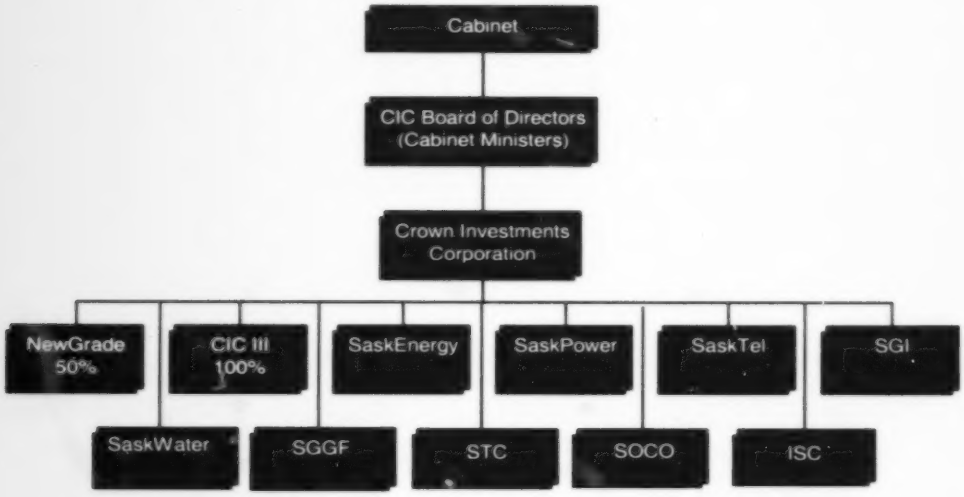
1. Status Quo	2. Management & Governance Separation	3. Outsourcing Investment Portfolio Management	4. Partial Equity Sale
FINANCIAL & PUBLIC POLICY OBJECTIVES			
Cabinet determines financial and public policy objectives for investment	Cabinet determines financial and public policy objectives for investment	Cabinet determines financial and public policy objectives for investment	Cabinet determines financial and public policy objectives for investment
OPERATIONAL MANAGEMENT			
Investments managed by a division within CIC. Share staff, location, with other CIC divisions	CIC III is autonomous entity with its own staff and an autonomous board	Fiduciary relationship between CIC III and independent external manager	Minority shareholder considerations impact management decisions
PORTFOLIO MANAGEMENT & PERFORMANCE			
Investment management included as part of CIC's plans [10] and reporting of results	Investment management company (CIC III) has separate plans[10] and reporting	Investment management company (CIC III) has separate plans[10] and reporting	Investment management plans[10] and reporting involve minority shareholder
ACCOUNTABILITY			
Active reporting to CIC Board, not CIC III Board	CIC III Board assumes full board responsibility	CIC III Board assumes full board responsibility	Appropriate involvement of minority shareholder in governance required
INVESTMENT DECISION MAKING			
Investment decisions made and overseen by government staff and government board	Investment decisions made by government staff, overseen by private sector board	Investment decisions made by private sector staff, overseen by private sector board	Dependent upon choice of governance

[10] Plans include capital plans, budgets and strategic plans.

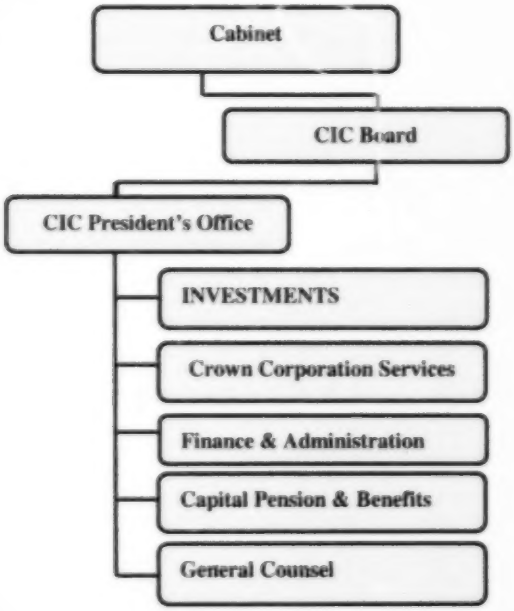
5.2 DESCRIPTION OF OPTIONS

5.2.1 OPTION 1: STATUS QUO

As described earlier in this report, CIC owns the investment portfolio, mostly through its ownership of CIC III as well as through its direct ownership of the NewGrade investment. This is illustrated in the following chart:



Management of the investment portfolio is provided by the Investments Division of CIC, as illustrated in the following chart:



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Investments managed by a division within CIC. Share staff, location, with other CIC divisions	CIC III is autonomous entity with its own staff and an autonomous board	Fiduciary relationship between CIC III and independent external manager	Minority shareholder considerations impact management decisions
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Active reporting to CIC Board, not CIC III Board	CIC III Board assumes full board responsibility	CIC III Board assumes full board responsibility	Appropriate involvement of minority shareholder in governance required
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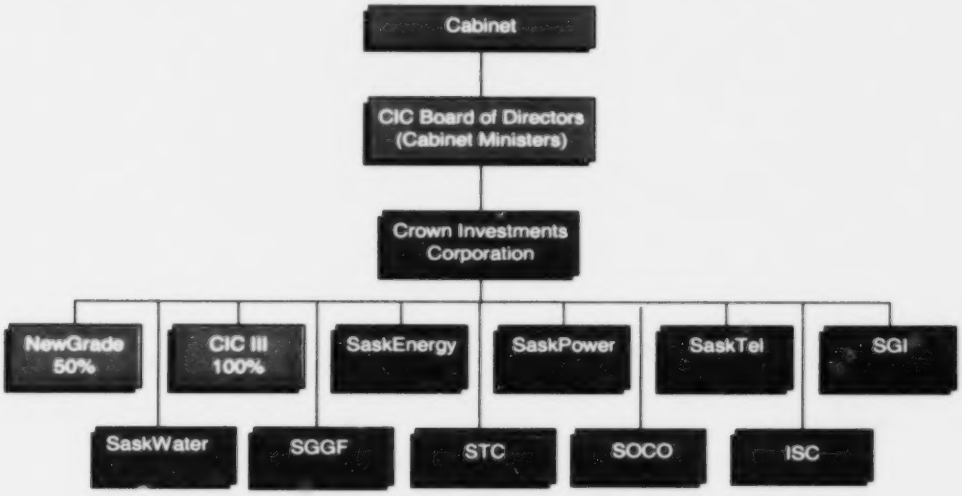

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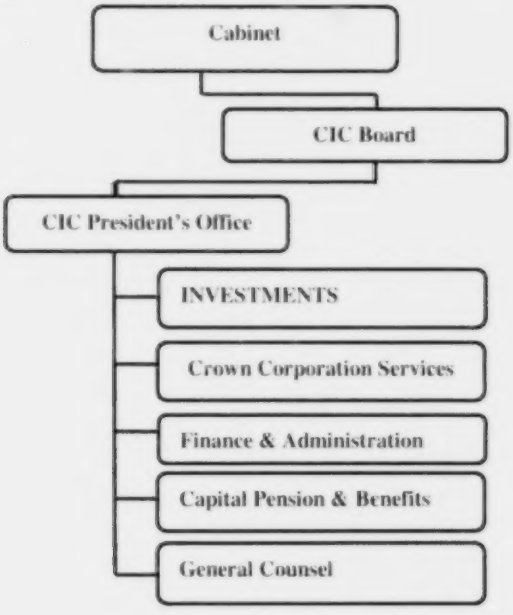
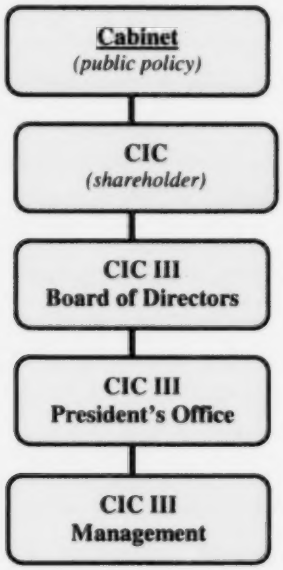


Highlights are as follows:

1. CIC Board performs board functions for all of CIC including Investments Division.
2. CIC Board authorizes acquisitions and dispositions of investments managed by Investments Division.
3. CIC III, a Business Corporations Act entity, wholly owned by CIC, owns all of the investments except NewGrade.
4. CIC III board fulfills legal requirements but does not actively participate in overseeing management of the portfolio. There is limited interaction between the board of CIC III and Investments Division staff.
5. Senior Vice-President of Investments Division reports to President and CEO of CIC.
6. CIC staff provide services such as finance, human resources, legal and communications with no costs attributed to the Investments Division.
7. Investments Division plans and reports as part of CIC.
8. 2003 operating budget of Investments Division is $5 million. This includes direct costs for management of the investment portfolio as well as costs related to other activities such as public-private partnerships. It does not include costs such as interest or support services.
9. 2003 financial objectives for the portfolio include ROE of 7.0% and investments up to $75 million.
10. 2003 economic development objectives include leveraging private capital at a minimum rate of 1.5:1 for direct investment and at 2.0:1 for fund investment; and creation of 200-300 jobs.

5.2.2 OPTION 2: MANAGEMENT & GOVERNANCE SEPARATION

Under this option, CIC III would become an autonomous entity but would remain wholly owned by CIC. A high level view of the governance structure is illustrated in the following chart:



The governance structure is based on a mixture of the current regime for subsidiary crown corporations and good governance practices for Business Corporations Act entities. The following are the key elements:

1. Cabinet and the CIC Board determine public policy objectives.
2. The shareholder (CIC) appoints board members for CIC III. Board members for CIC III are selected on the basis of the match of their competencies with the defined needs of CIC III.
3. The CIC III board appoints the CEO, evaluates the CEO, and determines the CEO's salary, including alternate forms of compensation.
4. The shareholder approves or provides direction to the CIC III board regarding public policy initiatives, performance measures, commercial and financial objectives and capital budgets.
5. Dividend policy is determined by CIC. The current crown dividend policy may require some tailoring for application to CIC III.
6. The board of CIC III determines the amount of CIC III's dividend.
7. CIC approves the creation of subsidiaries.
8. CIC appoints auditors.

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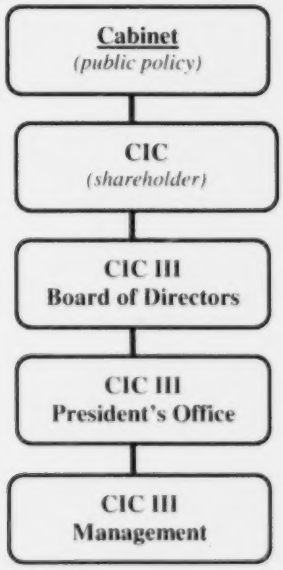

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8. CIC appoints auditors.

In most respects, the CIC III board could have authorities similar to those of other private sector incorporated companies. Cabinet and CIC control of CIC III and its investment portfolio could be exercised primarily through the articles of incorporation, the right to appoint or remove directors, communicating expectations to the CIC III board, contractual agreement, and through the right to approve bylaws.

A comparison of the governance for subsidiary Crowns as defined by the Decision Making Matrix and the governance described for CIC III as a BCA company is included as Appendix B.

CIC III will remain wholly owned by CIC but will not be designated as a subsidiary crown.

CIC III will continue to play a leading role in refining and implementing investment policies required to meet the government's financial and public policy objectives. There will be ongoing dialogue between Cabinet, CIC, and CIC III to determine the optimum approach to meeting policy objectives. For example, once the government defines a target sector, CIC III will work to identify potential partners and acceptable investment criteria.

Significant differences from Option 1: Status Quo include:

1. An autonomous CIC III board made up of non-government directors would replace the current CIC III "nominal" board whose members are CIC staff and the CIC minister.
2. CIC III's board would become active and take the company from a holding company to fully operational.
3. The CIC III board of directors would have conventional board responsibilities such as strategic oversight, providing stewardship of the assets, ensuring effective risk management, ensuring effective controls, and reporting to stakeholders.
4. A name change for CIC III would be appropriate in order to clearly distinguish it from the parent, CIC.
5. Cabinet could delegate authority to make individual investment decisions to the board of CIC III, which could have defined limitations.
6. Some or all of CIC Investments Division staff could become the initial staff of CIC III.
7. A CEO for CIC III will be required. Currently CIC III and CIC share a CEO.
8. CIC III would need to arrange for services such as financial reporting, communications, human resources and legal which could be done by staffing up, hiring outside providers, or a combination of both. These services are currently provided to Investments Division by CIC with no cost attributed to the investment portfolio.
9. CIC III would manage its own finances. Limitations could be placed on its borrowing powers and any required financing would be obtained through the facilities of the Department of Finance.

10. Performance reporting by CIC III including public policy initiatives, performance measures and commercial and financial objectives would be segregated from CIC's reporting.
11. CIC III would take a significant role in communicating such things as strategy, performance targets and investment portfolio results to all stakeholders.
12. Financial reporting in CIC III's annual report would be based on generally accepted accounting principals (GAAP), including appropriate consolidation of Meadow Lake Pulp, Centennial Foods, Sask. Valley Potato Corporation, Genex, and CIC Ventures. Revenue, expenses, assets and debt would increase substantially. Currently the financial statements for CIC III are reported on a non-consolidated basis for information purposes and are presented in conjunction with the CIC consolidated and non-consolidated financial statements.
13. CIC III would publish its own annual report, which would include a full management discussion and analysis section.
14. The CIC and CIC III annual reports and attendance at the Standing Committee on Crown Corporations would be separate and distinct from one another.
15. Communication with the Provincial Auditor will be required to ensure there is understanding of how CIC III's proposed governance and reporting will meet the transparency and accountability standards.
16. Strategic planning, business planning, and budgeting would be developed at the CIC III corporate rather than the CIC Investments Division level.
17. CIC III would account for its interest and administration expenses and report investment returns net of those costs.
18. GST would be paid by CIC III.

The Advisory Committee had the benefit of, and sincerely appreciates, input received, via videoconference, from representatives of SGF regarding implementation of a similar model in Quebec.

5.2.3 OPTION 3: OUTSOURCING INVESTMENT PORTFOLIO MANAGEMENT

The Advisory Committee believes that implementation of Option 2 would provide the foundation for further outsourcing such as that described in this option.

An independent external investment manager would be contractually engaged to manage the investment portfolio. While government maintains ultimate accountability for the investment portfolio, this independent external manager would manage existing investments and make future investment decisions according to the terms defined within the contractual agreements. CIC III would exercise control of the external manager primarily through the terms of the contract.

CIC would retain ownership of CIC III, and CIC III would retain ownership of the assets. The external investment manager would be independent of government and act in a fiduciary capacity for CIC III and the government. It is important that CIC III have trust in the external manager to allow it to operate as an effective fiduciary. This trust will depend on factors such as integrity, industry creditability and demonstrated expertise.

Establishing the contract between CIC III and the external manager will require definition of the investment objectives, performance parameters and levels of delegated authority. The chain of delegation should be documented and performance objectives and reporting relationships established between the roles.

Multiple contracts could be established with different objectives, parameters and levels of delegation to accommodate different pools of investments. For example, the following three classes of assets could be created with different contractual arrangements:

- Existing Assets. An asset plan would be established setting out the approved strategy and terms of authority for each asset, including the funds. The external manager would have limited discretionary powers.
- New Assets (non-standard constraints). CIC III would engage the external manager to invest and manage future investments to be made with the objective of fostering economic development in Saskatchewan.
- New Assets (standard constraints). CIC III would join other investors in a commingled investment vehicle. Contractual terms would be similar to those generally required by institutional investors. The external manager would have significant discretionary powers, and constraints would be defined in the offering memorandum.

The prospect of raising additional private capital to lever the government capital is a key element of this option. The external manager will lead sales and marketing to raise capital from other private sector partners, either on an investment by investment or a fund basis.

The Advisory Committee is of the view that Option 2: Management & Governance Separation (as described earlier) should be the first step, and should be implemented as soon as possible.

If this were the case, in general terms, the following are **illustrative** roles and responsibilities[11] which build upon the framework established under Option 2:

1. Cabinet

1.1 Determines:

a) Public policy objectives.

1.2 Approves:

a) Investment objectives.
b) Economic development objectives.

1.3 Delegates to CIC authority for:

a) Accountability framework outlining matters requiring Cabinet, CIC board or CIC III board approval as well as delegations of authority to the external manager, if that option is pursued.
b) Dividend policy.
c) Capital available.

2. CIC Board & Staff

2.1 CIC Board recommends to Cabinet:

a) Investment objectives.
b) Economic development objectives.

2.2 CIC Board approves:

a) Accountability framework outlining matters requiring Cabinet or CIC board or CIC III board approval and delegation of authority to the external manager.
b) Auditors.
c) Board members.
d) Dividend policy.
e) Capital to be available.
f) Strategic objectives.
g) Bylaw changes.

[11] As discussed in the Recommendation, the Advisory Committee believes the future CIC III board should have the authority to define the optimum approach.

2.3 CIC Staff conducts:

a) Oversight to determine acceptability of CIC III performance.
b) Review of strategic plans, annual business plans, and operating and capital budgets to ensure compliance with holding company and government priorities.
c) Activities required to support CIC board.
d) Liaison activities between CIC III and the CIC board and Cabinet.

3. CIC III Board & Staff

3.1 CIC III Board approves:

a) Choice of external manager.
b) Terms of the contracts with the external manager.
c) Investment policy and criteria, within established economic development and investment parameters. Parameters and measures would likely be established around capital deployment, investment return, job creation, and industry diversification.
d) Acceptability of performance of the portfolio and the external manager.
e) Selection and compensation of CEO.
f) Dividend.
g) Strategic and business plans, including operating budgets.

3.2 CIC III Staff:

a) Recommends to CIC III board the terms of contract with the external manager including incentive arrangements.
b) Develops an asset plan for each investment in conjunction with the external manager. These asset plans would include a description, estimate of value, operating information, asset management strategy and realization plan.
c) Fulfills all responsibilities delegated by the CIC III board.

4. External Manager

4.1 External Manager approves:

a) Individual investment decisions within its authority as defined by the accountability framework and the contractual terms established. At all times, the external manager acts in the best interest of the investor – i.e. CIC III, on behalf of the government of Saskatchewan as stated in its investment and economic objectives.

4.2 External Manager provides:

a) Assistance in developing asset plans.
b) Implementation of asset plans.
c) Identification and acquisition of potential new investments.
d) Oversight of existing investment funds (e.g. Foragen, Prairie Ventures, etc.).
e) Investment administration such as accounting, systems and back office functions.
f) Upon request, assistance in developing implementation plans for investment and economic development priorities identified by Cabinet or CIC.
g) Necessary reports.
h) Assistance in transition from internal government management of investments to use of external managers. This may include helping to establish a new organization, if required (e.g. management/employee firm).

It is anticipated that the external manager would want to acquire a significant number of the existing investment management staff in order to preserve knowledge of the portfolio and the Saskatchewan economy.

The external manager would expect to earn a management fee as well as a success fee if investments exceed performance targets.

5.2.4 OPTION 4: PARTIAL EQUITY SALE

As indicated previously, the shares of CIC III are currently wholly owned by CIC. Under this option, a portion of the equity of CIC III would be sold to a third party or parties for fair market value. The purchasers would be entitled to their proportionate share of future earnings or sales proceeds from investments held by CIC III.

The proceeds of the sale of equity unlock capital for the government, but would also introduce a minority shareholder(s) whose interests would need to be considered in future decisions, and which may prove to be incompatible with the interests and aspirations of the government. The governance structures for CIC III would need to be aligned with the changed ownership. For example, consideration must be given to share classes, voting rights, and unanimous shareholder agreements.

5.3 OPTION ASSESSMENT CRITERIA

While the Advisory Committee looked to the past experience of Saskatchewan and to other jurisdictions for evidence to support the choice of any of the options, they found, not surprisingly, that there were no perfect comparators. The assessment of the options by the Committee is based upon the collective knowledge and experience of the members of the Committee, combined with their review of available information.

The Advisory Committee applied the following criteria in their assessment of the options:

1. Maintain or enhance the assets, and their financial returns.
2. Achieve the shareholder's financial and public policy objectives.
3. Increase job creation and economic activity in the Province of Saskatchewan.
4. Reduce costs.
5. Lever greater private sector investment in the Province, and reduce the Province's financial exposure.
6. Attain a more arms-length structure for government's investment functions.
7. Allow the Government to replace some or all of its investment and/or future investment allocation with private sector capital.

As it applied the criteria to the options, the Advisory Committee considered questions such as:

1. How effective is the option in supporting the use of investment as a tool for economic development?
2. How well does the model address the market failure of insufficient venture capital capabilities within Saskatchewan?
3. Will the model improve the management systems for the portfolio?
4. To what degree will the model improve public understanding of the role of government as an investor?
5. To what degree does the model provide the government with future flexibility?

5.4 OPTION ASSESSMENT

5.4.1 OPTION 1 ASSESSMENT: STATUS QUO

The Advisory Committee identified the following positive aspects of the status quo organization structure, ownership, governance and management:

1. Accommodation of economic development requirements. Investments that do not meet the risk/return requirements of private investors are considered and sometimes funded. As well, CIC III can take the role of patient investor. CIC III also develops investment programs to implement policy decisions of Cabinet.
2. Acceptable portfolio performance, both in terms of returns and economic development.
3. Acceptable levels of private sector participation in investments.
4. Cost efficiencies and access to a large team of experienced staff thorough shared central services for finance, human resources, legal and communications.
5. Access to and responsiveness of CIC board for CIC III investment decision requirements and capital.
6. Appropriate input and accountability of CIC board and Cabinet for investment decisions.
7. Potentially increased availability of capital from the Department of Finance due to the greater diversification within CIC (subsidiary crowns and investment portfolio) than CIC III alone (investment portfolio only). The risk related to cash flow from the investment portfolio may be perceived to be higher due to the degree of concentration and the reliance on commodity based companies.
8. Does not currently pay taxes.

The Advisory Committee identified the following gaps related to the status quo governance and ownership structure:

1. There is incompatibility between CIC's two lines of business, subsidiary crown oversight and direct investment.
2. Clarity and transparency regarding the investment portfolio's objectives and results could be enhanced. For example, until recently, the return on equity (ROE) targets and results were not clearly communicated to the public.

3. Currently most individual investment decisions require CIC Board and Cabinet approval. CIC's board is made up of cabinet members, which may contribute to some public perception of inappropriate political involvement in investment decisions. The Advisory Committee believes that government is accountable for the performance of the investments made with public funds. However, the Advisory Committee is concerned that the public is not currently provided with good quality information that will assist understanding of the objectives or the performance of the investment portfolio.
4. Performance of individual investments overshadows the performance of the investment portfolio due to limited segregated reporting for CIC III. Within any investment portfolio, there will be winners and losers. The current financial reporting may contribute to the media's focus on the losers.
5. Investment management activities are limited to the government's portfolio. The government's requirements for investment management provide a significant base of business that could be used to stimulate creation of investment management businesses, similar to the model used in the creation of Greystone and the outsourcing of CIC's small investment portfolio.

The Advisory Committee recognizes that changes could be made to the Status Quo to address some of the above issues without changing the governance. However, the Advisory Committee fundamentally believes that combining the investment role with the subsidiary crown oversight role reduces the effectiveness of the investment management. The Committee is therefore recommending departure from the status quo.

The Committee fundamentally believes that separating the management and governance structure, including setting up a dedicated and focused board and management team for CIC III will lead to enhanced performance over and above the incremental cost.

5.4.2 OPTION 2 ASSESSMENT: MANAGEMENT & GOVERNANCE SEPARATION

The Advisory Board believes that the recommended management and governance structure provides for appropriate responsibilities to Cabinet, CIC as the owner, and the board and management of CIC III. For example, the CIC III board will be responsible for selecting, evaluating and determining compensation for the CEO, consistent with their overall responsibility for managing the business and affairs of the corporation.

The Advisory Board believes that this option could contribute to the following:

1. Creation of an entire organization, including a strong board, focused on using investment as a tool to meet the government's financial and public policy objectives. This could increase clarity and transparency regarding the government's investment objectives and results.
2. Enhanced accountability since the sole reason for the existence of CIC III is investment management, and it will have the flexibility to design optimum structures to achieve results.
3. Clearer and more transparent performance reporting since CIC III would report its administrative and interest costs.
4. Increased perception that investment decisions are of arm's length from political influence. For example, the governance structure will incorporate the concept that Cabinet's role is policy setting while CIC III's role is to make individual investment decisions.
5. Increased focus on the other benefits of government as an investor. For example, more attention could be given to CIC III's advantage of knowing the business and regulatory environment of the province when seeking extra-provincial partners.

The Advisory Board recognizes that this option may increase costs due to:

1. The change in size and composition of CIC III's board;
2. Losses of economies of scale of the CIC financial, legal, communication and administrative functions;
3. GST since costs will flow through CIC III, which is non-exempt; and
4. Transition costs.

Overall annual cost increases are estimated on a preliminary basis at approximately $400,000 per year for board expenses and potential increased costs for management and administration. Any financial savings from increased operational efficiency would help to offset these cost increases.

5.4.3 OPTION 3 ASSESSMENT: OUTSOURCING INVESTMENT PORTFOLIO MANAGEMENT

The Advisory Committee is of the view that outsourcing management could provide the following benefits:

1. Increase the government's ability to attract private sector capital, thereby reducing although not eliminating the need for government to provide capital. A credible private sector investment entity is more likely to convince other private sector partners to fund deals in Saskatchewan. To date, CIC has been successful at leveraging the government's funds with private sector capital on an asset-by-asset basis. Although CIC has participated in investment funds, these funds have tended to attract only Saskatchewan capital or, in the case of multi-jurisdictional investors, have limited the amount invested in Saskatchewan to the amount contributed by the government.
2. Capitalize on a window of opportunity to attract and negotiate a deal with an external investment manager. The investment portfolio has been managed to either remove or significantly write-down the carrying value of weak performing investments. This increases its attractiveness for outsourcing. At the same time, private equity is emerging as a more attractive investment vehicle. The convergence of these factors increases the likelihood of negotiating an attractive outsourcing agreement.
3. Create a significant private equity management entity in Saskatchewan, resulting in job creation. The CIC III investment portfolio is of a size that it provides the base for a significant player focusing on private equities. This entity may expand to managing investments beyond Saskatchewan.
4. Increase industry and investment expertise by broadening the available pool of professionals. In addition to ensuring good quality investment decisions, this broadens the support available to local investee companies.
5. Further increase clarity and transparency regarding objectives and performance of the investment portfolio. The process of negotiating a contract with an external party would necessitate clearly articulated objectives by the government. This could contribute to improved public understanding of the government's role and performance as an investor.

The Advisory Committee is convinced a balance of public policy and investment returns can be articulated and negotiated. However, if the CIC III and the government are unhappy with the performance of the outsourced manager, this arrangement should be possible to unwind.

Outsourcing management to an external provider could result in payment of management fees by CIC III. It is typical within the industry to have these fees based on a base operating fee combined with a success fee based on investments exceeding return hurdles. The nature of the current portfolio and the government's dual objectives of investment returns and economic development may result in complex negotiations regarding these fees. Regardless of the fee levels, it is possible there may be some criticism that the fees are windfall payments to the outsourced manager.

The Advisory Committee believes this option is similar to the development of Greystone Capital Management Inc. Greystone came into existence as the result of transferring the investment function in respect of approximately $3.4 billion of public sector pension and insurance funds out of the Department of Finance in 1988. The day-to-day investment management function was outsourced to Greystone, under contract; while the responsibility and accountability for policy, oversight and governance remains with the boards of trustees of the pension funds.

In the eleven years from its incorporation in 1988 until mid-1999, Greystone was wholly owned by the twenty founding public sector funds for which it managed investment assets. By the end of 1998, Greystone had grown its assets under management to $8 billion, even after accounting for approximately $2.5 billion of transfers during the intervening years to alternate managers. The company had attracted only a handful of clients in addition to its founders, representing less than $500 million of the total assets under management.

In June 1999, fifteen of the founders sold their majority interest in the company[12] to the employees. Since that time, Greystone has literally attracted dozens of new clients from coast to coast, and increased its assets under management to over $15 billion.

Today Greystone is Canada's fifth fastest growing investment management firm and in excess of 60% of its revenues are generated from clients other than the founders (all of whom still retain Greystone's services, albeit not exclusively). Greystone employs 57 employees in high quality jobs at its Regina head office. This is in contrast to the six positions eliminated in Finance in 1988.

[12] Ownership of the pension assets remained unchanged.

5.4.4 OPTION 4 ASSESSMENT: PARTIAL EQUITY SALE

The Advisory Committee believes that the major attraction of this option is the prospect of incremental capital from the sale. The Advisory Committee believes that better value could be achieved through the ongoing sale of existing assets and that incremental capital can be achieved through increased private sector participation on either an individual asset or fund basis.

The Advisory Committee rejected this option due to the following:

1. Increased federal income taxes if more than 10% of the equity is sold.
2. Increased complexity and decreased flexibility due to minority shareholder interests.
3. Increased risk of decreased effectiveness of economic development due to the misaligned objectives. While every effort would be made to avoid this through the terms of the contract, risk would increase to some extent.
4. Cost and complexity of valuing existing portfolio for the purposes of a transaction that effectively brings a minority shareholder into an ownership position in all of the existing holdings.
5. Respondents to the Requests for Expressions of Interest expressed limited interest for this process. Rather, respondents tended to focus on selling either individual or groups of assets.
6. It is believed that investor interest could only be achieved through some form of a discount to the buyer or preferential participation in the ultimate returns, neither of which are likely to receive public support. The province would be seen to have taken all the risk but received only part of the benefit.

5.4.5 ASSESSMENT OF TRANSFERRING OWNERSHIP OF THE INVESTMENT IN NEWGRADE

Currently CIC holds the government's ownership in NewGrade. Current forecasts are that NewGrade will generate positive cash flow over the next ten years. Possible uses of this cash include dividends from CIC to the General Revenue Fund or additional investment by CIC III. A decision is required by Cabinet or the CIC board regarding the most appropriate use for cash from NewGrade. If the cash is directed to CIC for dividend purposes, CIC III will require other means of ensuring capital will be available for investment purposes.

The Advisory Committee is of the view that management of this investment fits with the future role envisioned for CIC III, and that NewGrade is forecast to provide cash. When considering whether to transfer the ownership from CIC to CIC III, the following are among the factors that should be considered:

1. Potential impact on CIC, including net income and cash available for dividends to the GRF.
2. Potential impact on CIC III, including net income and cash available for investment and dividend purposes; and
3. Potential impact on the treatment of NewGrade income and sales proceeds for the purpose of calculating transfer payments for the Province. The Department of Finance has indicated that NewGrade would be treated differently for the purpose of determining equalization if it is owned by CIC III rather than CIC. This is being further investigated.

6.0 ADVISORY COMMITTEE RECOMMENDATIONS

The following is a summary of recommendations regarding the organization structure, ownership, governance and management of the investment portfolio.

The Advisory Committee suggests that it is vital to the ultimate success of this initiative that:

1. Appointment of a credible independent board of directors for CIC III be a priority; and,
2. The new board of directors be mandated to execute the implementation of the Committee's recommendations in this report.

6.1 RECOMMENDATIONS FOR PHASE 1

1. Ownership of CIC III: No change is recommended. CIC III should continue to be wholly owned by CIC.

2. Assets: All assets currently held by CIC III should remain in the portfolio, with the caveat that asset-by-asset disposition will continue when there are opportunities for sale that meet the investment strategy and guidelines.

3. NewGrade: Transfer ownership to CIC III, provided there are no significant legal or financial impediments. The NewGrade investment should continue to be managed as part of the investment portfolio. The benefits associated with the NewGrade investment would continue to accrue to CIC, albeit indirectly, through CIC's one hundred percent ownership of CIC III.

4. Management & Governance: Separate investment portfolio from CIC
   a) Appoint to the CIC III Board competent, credible experienced individuals from the private sector who have an affinity for Saskatchewan.
   b) CIC III approves investment decisions.
   c) CIC III Board to assume full board responsibility for governance and direction of CIC III.
   d) Transfer appropriate staff from CIC to CIC III.
   e) Cabinet continues to approve public policy initiatives.
   f) The shareholder, CIC, approves auditor appointments, board appointments, dividend policy, capital budgets, and creation of subsidiaries.
   g) CIC evaluates performance of CIC III.

5. Legal Structure: Continue as Saskatchewan *Business Corporations Act* entity.

6. Transparency and Accountability: Public reporting of targets and results such as:
   a) Investment returns, calculated on a five-year basis for the portfolio, should target exceeding the government's cost of five-year funds.
   b) Results reported primarily on a portfolio basis with individual investment details provided consistent with current venture capital industry standards for good disclosure.
   c) While hurdle rates for individual investment decisions will depend on the particulars of each investment, in general, hurdle rates for individual investment decisions (pre-investment decision) should often meet or exceed 15-20% since not all investments will be winners and since the government is prepared to take a higher risk profile.
   d) Economic development objectives regarding private sector funds levered and economic spin-off.

7. Branding: Change the name of CIC III to something less directly associated with government.

8. Capitalization: Provide CIC III with an appropriate capital structure that will, in the opinion of the new board, provide a sound financial footing and stability. This may also be accomplished through either an upfront capital injection or an ongoing commitment of funds availability.

6.2 CONSIDERATIONS FOR PHASE 2

1. The Advisory Committee is of the view that the new CIC III board should have the full authority and flexibility to make future decisions regarding the optimum management options for CIC III, therefore no specific directive recommendation has been made regarding outsourcing.

2. The Committee believes outsourcing management should be actively considered by the CIC III board as the Committee is of the view that it could offer significant benefits, including facilitating greater access to private sector investment capital for Saskatchewan based initiatives.

3. In addition, the Committee has a view that the outsourcing of management could provide the base and critical mass that could lead to another Greystone-like entity, based in Saskatchewan, operating on a national scale and attracting venture capital investors from across the country who make investments nationally.

The following are principles that the future CIC III board and management may wish to consider incorporating into agreements with any future external manager(s):

1. Commitment to managing within the government's stated investment and economic development targets.
2. Commitment to physically locate investment entity and team within Saskatchewan.
3. Commitment to cooperating with other Saskatchewan based investment managers.
4. Clearly defined roles for Cabinet, CIC, CIC III and the external investment manager.
5. Commitment to use best efforts to bring additional private capital (either their own or others) to Saskatchewan for investment).
6. In order to meet the test of due diligence in obtaining services establish that[13]:
   a) The provider is qualified;
   b) The provider's interests do not conflict with those of the government;
   c) The provider has sufficient financial resources for a stable relationship;
   d) The provider will deliver adequate performance and that it has measures in place to assess performance;
   e) The arrangement will provide good value for money; and
   f) The provider has the necessary procedures and controls to ensure that rules of confidentiality will be respected, that accurate records will be maintained, and that assets will be safe.

6.3 NEWGRADE

The Advisory Committee views NewGrade as an asset similar to those currently owned by CIC III. The Advisory Committee recommends transferring ownership of NewGrade to CIC III. If significant impediments emerge, the Advisory Committee recommends that management of NewGrade be provided by CIC III.

- Potential legal impediments. The Committee has been advised that while there are restrictions regarding transfer of CIC's equity interest in NewGrade, these should not prevent a transfer to CIC III.
- Impact on equalization. The Department of Finance has indicated, on a preliminary basis that NewGrade would be treated differently for the purposes of calculating equalization if it were owned by CIC rather than CIC III. In general terms, if CIC III is reporting a net profit, the taxback rate on CIC III profits from NewGrade could be approximately 12%.[14]

[13] Based upon OSFI's outsourcing guidelines contained within Guideline for Governance of Federally Regulated Pension Plans dated May 1, 1998.

[14] Department of Finance – May 23, 2003 and May 27, 2003.

6.4 POTENTIAL ISSUES RELATED TO RECOMMENDATIONS

The Advisory Committee recognizes the following potential issues related to their recommendations:

1. Individual Investment Decisions by CIC III

The Crown Corporations Act requires Order in Council approval for the acquisition of shares, bonds, etc. of a business organization. In addition to CIC or Cabinet approvals, some type of fund structure such as that used for Foragen and Prairie Ventures may be required to permit the board and management of CIC III to make decisions regarding individual investments.

2. NewGrade Cash Flow

Under the current ownership structure, NewGrade's dividends flow directly to CIC's net income, and cash is paid directly to CIC.

Current forecasts are that NewGrade will generate positive cash flow over the next ten years. Possible uses of this cash include dividends from CIC to the General Revenue Fund or additional investment by CIC III. A decision is required by Cabinet or the CIC board regarding the most appropriate use for cash from NewGrade. If the cash is directed to CIC for dividend purposes, CIC III will require other means of ensuring capital will be available for investment purposes.

Transferring NewGrade to CIC III will increase risk related to the availability of cash and the level of the CIC dividend. NewGrade cash dividends could still be paid to CIC from CIC III through a reduction in the "due to/due from" account but the amount of NewGrade associated dividend that can flow from CIC III to CIC will depend on the overall performance of CIC III. The extent of this risk must be assessed against the forecast amount and risk of expected future earnings from the other CIC III investments.

Transferring NewGrade will likely impact its treatment for the purpose of equalization payments for the Province.

3. Using Investment as a Tool to Implement Public Policy

Currently the Investments Division of CIC III dedicates significant resources to fleshing out public policy initiatives established by Cabinet. For example, when the decision is made to further develop a particular industry, it is the Investments Division that identifies potential structures and target partners. If the additional step is taken of outsourcing to an external manger, consideration must be given to how this role will be fulfilled in the future.

4. Lack of Clarity due to CIC III as a BCA company wholly owned by CIC

There are differences between the Crown Corporations Act and the Business Corporations Act. For example, BCA companies have their directors appointed by the shareholder whereas designated subsidiary crowns have their directors appointed by Cabinet. CIC III will not be designated a subsidiary crown. There may be ambiguity regarding which legislation applies.

It is also unclear to what degree CIC III will be bound by the Balanced Budget Act.

5. Capitalization of CIC III

As of December 31, 2002 CIC III had $340 million of share capital, retained earnings of $53 million and owed $179 million to CIC. Leaving the $179 million owing or converting it to equity may result in higher debt for CIC. Converting this to GRF debt will increase interest costs for CIC III.

Another consideration is CIC's policy against equity stripping when collecting dividends from subsidiary crowns. The capital structure of CIC III will impact to some degree its future ability to pay dividends within this policy constraint.

6. Transition from Current to New Structure

The Advisory Committee recommends that consideration be given to transferring the current Investments Division to CIC III. However, there will be a need to determine which specific employees will transfer; and whether any, additional employees and functions will transfer from the existing CIC to the new CIC III structure. This has implications for the costs and operations of both organizations.

6.5 CONCLUSION

This report provides the Advisory Committee's recommended conceptual framework for the future organization structure, ownership, governance, and management of the investment portfolio. The Advisory Committee understands that implementation of the recommendations will require further due diligence and refinement.

APPENDIX A – TERMS OF REFERENCE

BACKGROUND

On June 20, 2002 the CIC approved a recommendation from CIC management to undertake a formal process to develop and analyze options for the alternative management and possible sale of the CIC III investment portfolio.

A Request for Expressions of Interest (RFEI) was undertaken in July, 2002 to receive interest from major Saskatchewan and national investment agencies to work with CIC to development future options for CIC III's large investments portfolio individually greater than $3 million, and CIC's NewGrade investment. Responses were received in August 2002.

On September 23, 2002 a Request for Proposal (RFP) was undertaken for management options of CIC III's small investments portfolio. The RFP included all CIC III investments individually less than $3 million, including former SOCO, SEDCO and SDC investments. A shortlist was developed, and interviews performed. A recommendation to out source management of the CIC III small investment portfolio will be brought forward to CIC Board by year-end.

In November 2002, CIC management received approval from the CIC Board to appoint an Advisory Committee of private sector individuals to review options for the future of CIC III's portfolio of large investments individually greater than $3 million, and the NewGrade investment.

SCOPE OF THE REVIEW

CIC's approved investment strategy is:

> To facilitate and enhance Saskatchewan's economic growth by strategically investing in specific sectors of the economy where wealth and employment growth potential are significant, and where Saskatchewan has identified strengths and consequently is, or can be, globally competitive.

The Advisory Committee is not being asked to review CIC's approved investment strategy, but rather to review options for effectively implementing the strategy and meeting its goals.

The Advisory Committee will review the future of CIC's wholly-owned subsidiary CIC Industrial Interests Inc. (CIC III), and CIC's NewGrade investment, and consider whether alternative forms of organization and ownership would better attain the shareholder's financial and public policy objectives.

The Committee will consider if alternative sources of organization and ownership of CIC III, and the NewGrade investment can:

- Maintain or enhance the assets, and their financial returns
- Achieve the shareholder's financial and public policy objectives
- Increase job creation and economic activity in the Province of Saskatchewan
- Reduce costs
- Lever greater private sector investment in the Province, and reduce the Province's financial exposure
- Attain a more arms-length structure for government's investment functions
- Allow the Government to replace some or all of its investment and/or future investment allocation with private sector capital

Options to be considered could include, but are not limited to:

- Status quo organization and ownership (including joint ventures, project by project disposition)
- Reorganization of CIC III with no change in ownership (outsourcing management, standalone corporation)
- Reorganization of CIC III with changes in ownership (including partial sale of a standalone corporation, partial sale of a sub-set of projects, outsourcing management, total sale)

PROJECT MANAGEMENT AND RESOURCES

A Chair of the Advisory Committee will be selected among the members.

CIC staff will provide support and secretariat services to the Committee as required. Staff will be assigned to the Committee at the first meeting.

T. Bakkeli Consulting Inc. has been retained by CIC to provide research, analysis and financial modeling for the project, and can be assigned to particular aspects of the review, as the Committee requires.

The Committee will have the ability to retain other experts and consultants as required to meet their mandate, subject to the approval of CIC's President & CEO.

The Committee may ask the CIC Executive to attend any meetings they deem necessary, and ask for their participation, knowledge and expertise at any time during the review.

METHODOLOGY

1. Review background and work previously conducted on this project, and current CIC III and CIC investment status including:

    - Shupe Report – Investment Review (2000)
    - Draft Corporatization of CIC III Cabinet Decision item (2001)
    - Draft National Bank Report on CIC III (2001)
    - Draft document on the transfer of NewGrade into CIC III (2002)
    - CIC III, and CIC current financial statements and forecasts
    - Reports and information on the current status of the portfolio, including valuations of the major investments.

2. Review the Request for Expressions of Interest proposals received earlier this year, and the proposal summaries and rankings against the RFEI criteria. Request further information and conduct interviews as appropriate with potential partners with CIC III.

3. Review implications related to the internal environment, including but not limited to financial, legal, governance, tax, audit, and public disclosure, and the degree to which any of the options being considered would positively or negatively effect CIC III and its shareholder CIC.

4. Review implications related to the external environment, including but not limited to impacts on job creation, economic growth, private sector investment in the Province, availability of investment capital for larger sized projects in Saskatchewan, acceptance and impacts on the business community and the public.

5. Further review any viable option(s) through financial modeling, and more detailed development of the option(s) required to produce a report.

6. Prepare a report which incorporates the results of the review into an analysis of the options, and a recommendation to the CIC Board.

TIME TABLE

The Advisory Committee will undertake their work over several months, concluding with a report.

APPENDIX B – DECISION MAKING AUTHORITIES

	CIC Subsidiary Crowns			Option 2 – Management & Governance Separation		
	Crown Board	CIC Board	Cabinet	CIC III Board	CIC Board	Cabinet
GOVERNANCE						
Appointment of Auditors	Recommend	Appoint	Approve	Recommend	Approve	
Board Appointments	Nominate	Recommend	Approve	Nominate	Approve	
Crown Board Performance	Assess	Assess Recommend	Approve	Assess	Approve	
CEO Appointment	Recommend	Approve	Review	Approve		
Board Compensation		Approve		Approve		
PERFORMANCE MANAGEMENT						
Public Policy Initiatives	Report	Recommend	Approve	Report	Recommend	Approve
Performance Measures	Review	Approve		Report	Approve	
Commercial and Financial Objectives	Recommend	Approve		Recommend	Approve	
Dividends	Recommend	Approve		Approve amount	Approve policy	
Capital Budget	Recommend	Approve		Recommend	Approve	
OPERATIONS						
Foreign Investment	Recommend	Review Recommend	Approve	Approve		
Creation of Subsidiaries	Recommend	Recommend	Approve	Recommend	Approve	
Annual Report	Approve			Approve		
Operations	Review			Review		
Strategic Plan	Approve			Approve		
Business Plan	Approve			Approve		
Operating Budget	Approve			Approve		
Operating Goals and Objectives	Approve			Approve		
HR STRATEGIC						
CEO Salary	Recommend	Approve	Review	Approve		
Management Performance	Assess			Approve		
Other Exec. Salary Ranges	Recommend	Approve		Approve		
Collective Bargaining Mandate	Recommend	Approve		Approve		
Alt. Forms of Compensation	Recommend	Approve		Approve		
Succession Plan	Approve			Approve		

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	CIC Subsidiary Crowns			Option 2 – Management & Governance Separation		
	Crown Board	CIC Board	Cabinet	CIC III Board	CIC Board	Cabinet
GOVERNANCE						
Appointment of Auditors	Recommend	Appoint	Approve	Recommend	Approve	
Board Appointments	Nominate	Recommend	Approve	Nominate	Approve	
Crown Board Performance	Assess	Assess Recommend	Approve	Assess	Approve	
CEO Appointment	Recommend	Approve	Review	Approve		
Board Compensation		Approve		Approve		
PERFORMANCE MANAGEMENT						
Public Policy Initiatives	Report	Recommend	Approve	Report	Recommend	Approve
Performance Measures	Review	Approve		Report	Approve	
Commercial and Financial Objectives	Recommend	Approve		Recommend	Approve	
Dividends	Recommend	Approve		Approve amount	Approve policy	
Capital Budget	Recommend	Approve		Recommend	Approve	
OPERATIONS						
Foreign Investment	Recommend	Review Recommend	Approve	Approve		
Creation of Subsidiaries	Recommend	Recommend	Approve	Recommend	Approve	
Annual Report	Approve			Approve		
Operations	Review			Review		
Strategic Plan	Approve			Approve		
Business Plan	Approve			Approve		
Operating Budget	Approve			Approve		
Operating Goals and Objectives	Approve			Approve		
HR STRATEGIC						
CEO Salary	Recommend	Approve	Review	Approve		
Management Performance	Assess			Approve		
Other Exec. Salary Ranges	Recommend	Approve		Approve		
Collective Bargaining Mandate	Recommend	Approve		Approve		
Alt. Forms of Compensation	Recommend	Approve		Approve		
Succession Plan	Approve			Approve		